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To:

Subject: Timber

This is in response to your question about how a taxpayer computes gain on the sale of timber from a tract of land owned by the taxpayer. The taxpayer must maintain a basis for the timber that is separate from the basis in the land. The regulation below shows this in the discussion of the basis used for determining a taxpayer's cost depletion deduction on the sale of timber; see the underlined portions.

§ 1.612-1 Basis for allowance of cost depletion.

(a) In general. The basis upon which the deduction for cost depletion under section 611 is to be allowed in respect of ... timber property is the adjusted basis provided in section 1011 for the purpose of determining gain upon the sale or other disposition of such property except as provided in paragraph (b) of this section. The adjusted basis of such property is the cost or other basis determined under section 1012, relating to the basis of property, adjusted as provided in section 1016, relating to adjustments to basis, and the regulations under such sections. In the case of the sale of a part of such property, the unrecovered basis thereof shall be allocated to the part sold and the part retained.

(b) Special rules. (1) The basis for cost depletion of ... timber property does not include:

(i) Amounts recoverable through depreciation deductions, through deferred expenses, and through deductions other than depletion, and

(ii) The residual value of land and improvements at the end of operations.

... In the case of timber property, the basis for cost depletion does not include amounts representing the cost or value of land. (Emphasis added.)

As you are aware, a taxpayer who disposes of timber does not always take a depletion deduction on the timber sold. Depending on how the taxpayer makes the disposition, how the taxpayer holds the timber, and the elections that the taxpayer makes, the taxpayer may use the adjusted depletion basis of the timber in computing gain or loss under § 631(a) or (b) on the timber instead of taking a depletion deduction.

Generally, at the time a taxpayer acquires land and timber, the taxpayer should allocate the taxpayer's basis between the land and the timber.

The tax treatment of timber owners is described in the Market Segment Specialization Program (MSSP) – Hardwood Timber Industry. Page 3-2 is a good description of this tax treatment for various ways that a taxpayer can hold and dispose of timber.

If you would like to discuss this further, please give me a call.